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# Investments and industry will lead the return to growth

The financial crisis has halted the expansion of the Brazilian economy. The result for 2009 – when the GDP didn't grow – contrasts with the 4.8% average growth registered between 2004 and 2008.

There is a positive vision in the Brazilian economy's response to the crisis. A dynamic domestic consumption market was crucial in this regard. Strong macroeconomic foundations allied to an effective mix of monetary, credit and fiscal incentives contributed to reducing its impacts on demand and, therefore, on economic activity.

This does not mean that 2009 was an easy year, particularly for industry. After a strong adjustment process, industry is on a recovery path. However, the crisis has not yet been fully overcome. On average, production, turnover and job levels are still lower than the ones registered before the crisis. Manufacturing will only return to pre-crisis levels in the first half of 2010.

The country will resume its expansion cycle in 2010, when GDP is expected to increase again, by about 5.5%. Industry's product, which decreased by 4.5% in 2009, will lead the expansion, with a 7-percentage point increase.

Some facts are worth mentioning in this new phase of the Brazilian economy. A positive aspect is that investments have been resumed. Leveraged by renewed confidence and by a reversion in the high idleness prevailing in 2009, investments will be vigorously resumed in 2010. Investment rate, which had dropped to 16.9% of GDP, are expected to hit the mark of 18.3%.

The appreciation of the real is a threat that cannot be disregarded and will impact on the industrial productive structure. Given the lack of more solid advances on issues affecting the Brazil Cost, appreciation risks become more explicit in a less dynamic and more competitive global market.

Other aspects deserve special attention too. A steady upward path for the growth rate must be backed by higher domestic savings, particularly public savings. The return of growth will recover the fiscal indicators, which had deteriorated as a result of the crisis. However, the quality of the fiscal policy can still be disputed, as it contemplates lower public investments. This is a key difference in relation to high-growth emerging economies.

## 2009 overview

# International economic crisis prevents economic growth in 2009

Brazilian economy is not likely to grow in real terms in 2009. The significant economic growth cycle experienced in recent years was interrupted by the effects of the crisis that hit the world economy in 2008. A 0.9% drop in GDP in the first quarter in relation to the last quarter of 2008 confirmed a recessive scenario in the Brazilian economy, which retracted for two quarters in a row. However, the negative impacts of this scenario lost momentum over the year and the economy grew by 1.1% and 1.3% in the two following quarters. CNI expects to see a 1.9% economic growth in the fourth quarter.

This recovery of the Brazilian economy was led by household consumption, which resumed a growth path. After dropping slightly in the first quarter (0.4%) as compared to the fourth quarter of 2008, consumption grew in the two following quarters at rates in excess of 2.0%.

While consumption was not as strongly impacted by the crisis, the same cannot be said of gross formation of fixed capital, which decreased by 11.0% in the first quarter and grew by only 2.0% in the second. Investments only began to recover in the third quarter, when they grew by 6.5% in relation to the previous quarter. Data on the increase of capital good production in October as compared to the previous month and data on increased capacity utilization in the industrial sector point to continued recovery in the fourth quarter.

Apart from having affected demand components in varying intensities, the negative effects of the economic crisis impacted major economic sectors in different ways as well. Industry saw a significant drop in production in the three last months of 2008. Therefore, although production increased in all months between January and October 2009, the seasonally adjusted indicator for production in the manufacturing industry is still 6.6% below pre-crisis levels (September 2009).

On the supply side, industry will be the GDP component with the strongest influence negative on Brazil's economic performance in 2009. CNI estimates that industrial GDP will drop by 4.5% in 2009. This decrease is attributed to the negative effects of the economic crisis on the manufacturing industry GDP, which is expected to decline by 6.1%, and to that of civil construction, which will drop by 5.7%. CNI estimates point to a 0.7% growth in the extractive industry GDP and to a 1.5% increase in the GDP of public-utility industrial services.

This negative behavior of the industrial sector can be explained by a weak foreign demand. Economic recession hit most countries, and despite signs of recovery in some of them, its effects on foreign trade are proving to be more lasting. Brazilian exports hit the mark of US$ 139 billion between January and November 2009, meaning that they decreased by 22.9% in relation to the same period in 2008. On the other hand, Brazil also reduced its purchases abroad and imports declined by US$ 115 billion up until November 2009. This amount is 28.7% lower than the one accumulated over the same period in 2008.

With foreign demand at a low ebb, the economic activity recovery process was sustained by a rise in domestic demand, a phenomenon that can be basically explained by four factors: an increase in federal government cash transfers, tax exemptions, a heated labor market, and recovery in credit supply.

Cash transfer programs have grown steadily in recent years and the same trend continues in 2009. Together, spending with social security benefits, social assistance, unemployment insurance, special salary raises, and the *Bolsa Família* (Family Grant) program grew by about 8.0% between January and October 2009 in real terms as compared to the same period in 2008.

Tax exemptions granted by the federal government in response to the economic crisis hit the mark of R$ 13.5 billion in 2009 alone. As a result, they helped to sustain demand for various products, with repercussions on demand along their production chains.

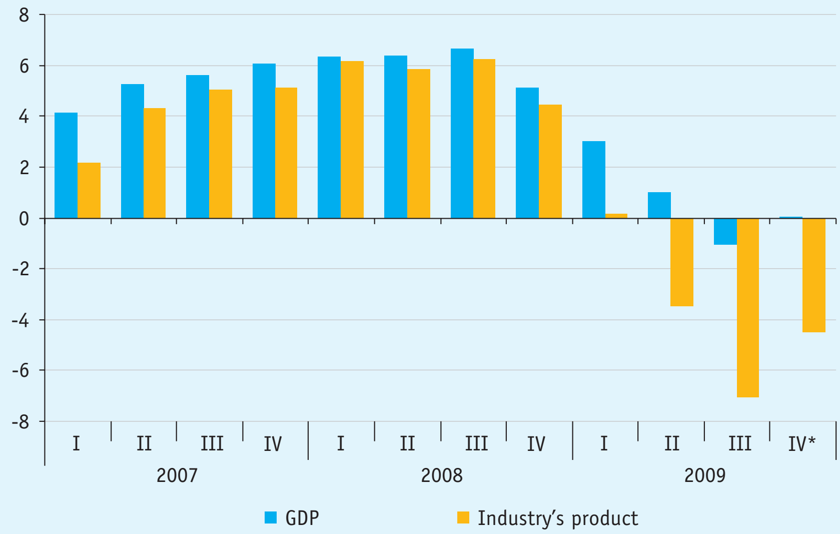
The labor market was strongly affected in the first months of the economic crisis. Between November 2008 and April 2009, a loss of 647,000 formal and informal jobs was registered. However, in the middle of the second quarter, new jobs began to be generated and one million formal jobs were created in the first ten months of 2009. As a result, total earnings increased by 3.6% in September in relation to the same month in 2008.

A lower inflation enhanced the positive impacts of cash transfers and higher total earnings on consumption. The Extended Consumer Price Index (IPCA), which had risen to 6.4% a year in November 2008, decreased to levels closer to the target in 2009 (4.5% a year). This IPCA movement was caused by two structural factors: Brazil's dependence on agricultural commodities and the strong impact of the crisis on the Brazilian industry. On the commodity side, the international prices of foodstuffs dropped significantly, affecting their prices domestically.

**GDP and Industry's product evolution**

Variation (%) in 4 accumulated quarters in relation to the 4 previous quarters

Brazilian industry was heavily affected by the international crisis




* CNI Estimate
Source: IBGE (Brazilian Institute for Geography and Statistics)

A lower increase observed in the prices of industrial products was attributed to the impact of the crisis on this sector and to tax exemption measures taken by the government. These two factors prevented the exchange rate depreciation, which hit the mark of 50% in the second half of 2008, from having a greater impact on inflation.

A lower inflation also favored a credit supply recovery process by making it possible to reduce the Selic rate. Between January and July, the Selic rate decreased by 4.0 p.p., from 13.75% to 8.75% a year. However, the supply of credit was resumed in different ways for natural persons and corporations. While credit for individual borrowers has recovered strongly, credit for corporations has not yet recovered fully.

The economic crisis also reflected in public accounts. On the one hand, it led to a significant reduction in revenues due the economic slowdown and to the lower profitability of enterprises. On the other hand, because the fiscal policy was actively used to buffer the effects of the crisis, government spending and tax exemptions were intensified, reducing the tax revenue even more. As a result, the primary surplus decreased from 3.7%, in 2008 to 1.55% of GDP in 2009.

Even though a higher public spending in moments of economic slowdown is a positive phenomenon, the loss of quality in the fiscal policy implemented in 2009 raises concerns. Current spending increased by R$ 42.6 billion, while investments grew by only R$ 3.0 billion.

# PROSPECTS FOR 2010

## Expansion in domestic market makes it possible to leave economic crisis behind

The Brazilian economy will be growing at a fast pace early in 2010, leading to a real GDP increase of 5.5%. This growth will once again by sustained by domestic demand, since the expected contribution of the foreign trade sector is negative. The following main factors will affect economic growth in 2010:

**Household consumption:** the demand component that sustained the economy in 2009 is once again expected to play a major role in ensuring positive results in 2010. Consumption levels will be favored by the continued recovery of the labor market, and jobs are likely to grow at a faster pace in 2010. As a result, with inflation under control, total earnings will increase more intensely, hitting the mark of 5.0% in real terms. In addition, total credit outstanding for individual borrowers will grow and government cash transfers will continue to increase at a high pace. All of these factors will lead to a 5.6% increase in household consumption.

**Investments:** the recovery process observed in the third quarter of 2009 is expected to continue in 2010. Higher capacity utilization levels in industry, higher confidence among industrial entrepreneurs, and the lower cost and greater availability of long-term financing are the factors that make it possible to anticipate this higher investment trend. In this scenario, investments are expected to grow by 14.0% in 2010, i.e. more than twice as much as the GDP.

**Foreign trade sector:** considering that economic recovery in most countries will be slower than in Brazil, exports are projected to increase less (11.0%) than imports (20.0%), according to the National Accounts methodology. This strong import growth pace will be led by the higher purchasing power of Brazilians combined with exchange rate appreciation.

The expected economic growth in 2010 will lead manufacturing production to exceed the levels observed before the financial crisis in the first half of 2009. As a result of the industry's recovery, this will be the GDP component that will grow most in 2010 on the supply side: CNI estimates a 7.0% industrial GDP growth. For the manufacturing and civil construction industries, CNI estimates a growth of 7.5% and 5.0% next year, respectively.

## Appreciated exchange rate and lower trade surplus

Exchange rate appreciation will continue to be a problem. The Brazilian currency will continue to appreciate for several reasons. One of them is the entry of foreign resources to finance a higher current account deficit. In part, these resources will come from direct foreign investments, which decreased during the financial crisis but are expected to grow once again in 2010 due to the attractiveness of the expanding

Brazilian market. Another reason is the US interest rate, which is projected to remain very low and stimulate loan-taking in US dollars for investments in countries such as Brazil.

In this scenario, we expect the real to continue to appreciate, albeit at a slower pace as a result of Central Bank interventions and likely tax measures by the federal government. The exchange rate is likely to close 2010 at about R$ 1.70 / US$ 1.

As a result of the faster growth pace of the Brazilian economy and of the exchange rate appreciation, imports are projected to resume a fast grow pace in 2010. This growth will be observed in all use categories. Imports will thus total US$ 175 billion in 2010, a 38% growth as compared to 2009.

Exports are also likely to grow once again in 2010, mainly due to price increases. In addition, exported volumes are also expected to increase, mainly as a result of the more intense growth of developing country economies. Exports will thus amount to US$ 188 billion in 2010, 24% more than in 2009.

Given the expectations for exports and imports, the trade balance is projected to total US$ 13 billion in 2010. A lower trade surplus and a higher deficit in services and income will lead the current account gap to hit the mark US$ 48 billion (2.5% of GDP).

## Inflation on target and stable interest rates

The exchange rate appreciation and the effects of a weak foreign demand on international commodity prices led to a stable inflation scenario in 2010. The Extended Consumer Price Index (IPCA) is thus expected to remain close to the core inflation target (4.5% a year) and to accumulate a 4.7% increase in 2009.

The expected behavior of inflation in 2010 will make it possible for the Central Bank to keep the Over-Selic interest rate at 8.75% throughout the year.

## Better fiscal indicators

The fiscal scenario is expected to improve significantly in 2010 as a result of a real 8.2% growth in the net federal government revenue in 2010 in relation to 2009. This increase will be brought about by resumed economic growth and less strong impacts of tax exemptions on the tax revenue.

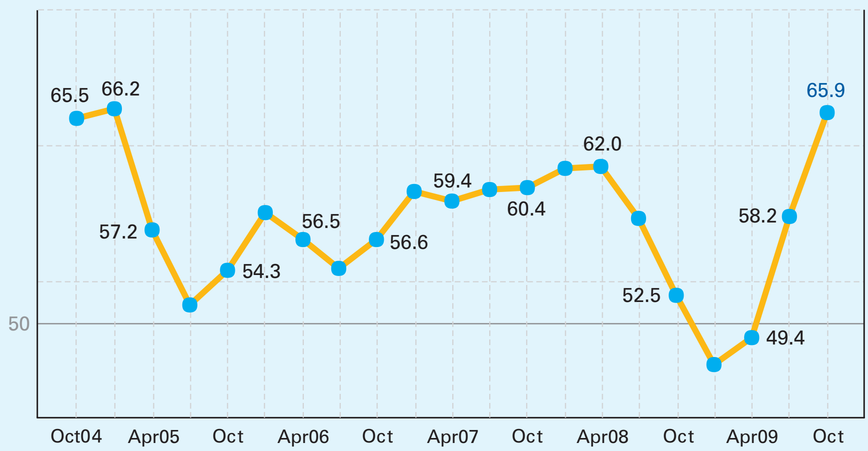
Despite these higher revenues, the public sector primary surplus will amount to only 2.6% of GDP and will require a corresponding reduction in the primary surplus target (3.3% of GDP) for PAC (Growth Acceleration Program) investments (0.7% of GDP).

Considering that interest spending is projected to be substantially lower in 2010, the nominal deficit is likely to drop to 1.9% of GDP, reducing the debt/GDP ratio to 40.5% of GDP.

**Business Confidence Index - ICEI**

Index number

Confidence of industry has risen to pre-crisis levels already




The BCI varies in the 0 - 100 interval. Figures above 50 suggest that entrepreneurs are confident.
Source: CNI

# CHANGE IN THE WORLD SCENARIO

## Impacts of the crisis on foreign trade prove to be lasting

The latest estimates for the world GDP evolution were revised upward, both for 2009 and 2010, after advanced countries began to gradually recover from the crisis. However, the positive surprises that led to this revision will become increasingly rare and growth expectations are therefore likely to level off, correcting the strong adjustment process observed during the crisis.

The effects of the crisis on international trade proved to be more lasting. The latest data show that most countries are experiencing improvements in their economic activity to some degree since the second quarter, although not even close to pre-crisis levels in the large majority of cases. At the same time, exports are also recovering, albeit slowly.

Stocks, which grew in the early stages of the crisis and were rapidly adjusted – at the expense of considerable adjustments in production, as observed in the first half of 2009 – are one of the factors leading manufacturing activity to be resumed. This means that the manufacturing activity recovery process is not related to exports.

In addition, tax incentives granted by different countries to make up for the effects of the crisis were mostly focused on consumer goods, which tend to be produced domestically.

Since idleness in industry remains generally high, the recovery of investments – and consequently demand for capital goods – will be very slow. Protectionist measures adopted during the crisis are also expected to continue for some time. These factors are projected to prevent a rapid recovery in exports of industrial goods, particularly machinery and equipment.

Discrepancies were also observed in comparisons between different countries. Among developing countries, the speed and intensity of economic recovery came as a positive surprise. In most of these countries, the banking system was not deeply affected, domestic demand remained strong, and a return of confidence made them the target of considerable foreign investments. In some countries, interest rates are on the rise again and tax incentives are being eliminated.

In 2010, the removal of these incentives will be offset by continued growth in consumption and private investments. These countries are therefore expected to experience a significant growth in 2010.

In the case of developed countries, the main limitation preventing demand from growing is the labor market, which will take longer to recover. Exports of these countries (made up of industrial goods) will continue to be relatively more affected than those of developing countries. Tax measures to restrain the crisis will be more lasting, as will protectionist measures.

The dynamism of the world economy is gradually shifting toward emerging countries. The big issue is whether China and other countries can replace, or at least partly make up for, a lower consumption in the US in coming years and ensure a fast growth internationally. This is a concern based on the US scenario, which has less financial leverage and is still suffering the impacts of the crisis, particularly in its labor market.

Consumption will not be enough to make up for these impacts in the short term. Consumption in the US accounts for 30% of global consumption. For this reason, a significant and not very likely increase in consumption in China and other countries would be necessary to make up for the economic slowdown observed in the US.

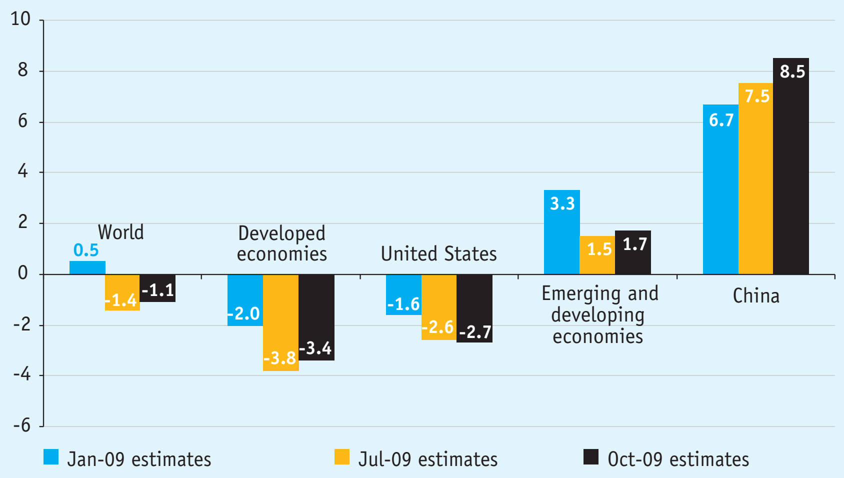
International macroeconomic adjustments will be led by investments, with China accounting for more investments internationally than the US. Continued growth at a fast pace in China and other emerging countries, whose share in world investments is increasing, will at least partially contribute to offset a lower consumption growth in the US. As a result, world growth in 2010 is likely to be sustained by the resuming of investments and private consumption in emerging countries.

Forecasts for world GDP growth of the International Monetary Fund (IMF) reflect this difference between the expected performance of developed and emerging countries. Among developed countries, the IMF expects to see a 3.4% drop in 2009 and a 1.1% growth in 2010. For emerging countries, a growth of 1.7% in 2009 and of 5.1% in 2010 is anticipated.

**Evolution of GDP estimates for 2009**

Variação percentual

Estimates for GDP variation in 2009 have become more pessimistic over the year, exception in China




Source: IMF

China's GDP is expected to grow by 8.5% in 2009 and by 9% in 2010. For Brazil, the IMF projects a drop of 0.7% this year and a growth of 3.5% in 2010.

## What can go wrong?

There are some risks involved for this scenario to be consolidated. One of them is a slower-than-expected recovery of the main emerging countries, particularly of China. Should this happen, the recovery of different countries, particularly emerging Asian countries, will be less intense. Risk aversion on the part of investors may increase, reducing the entry of capitals and scaring investments away, even from countries without a direct relationship with these emerging countries.

Lingering uncertainties in the international financial system constitute another risk factor. Signs of weakness remain, preventing sustained improvements in credit conditions. Even in a favorable scenario, credit conditions will not return to pre-crisis levels in 2010.

Finally, there are also fiscal risks. Many governments will face a marked spending – and indebtedness – rise as a result of expansionist measures to address the international crisis. With their slower recovery and higher indebtedness capacity, developed countries are not expected to make significant adjustments. It should be stressed, however, that various countries will not have this option or may see themselves in a more favorable scenario for their fiscal adjustment.

economic activity

# After economic recession, GDP is once again on a consistent growth path

2009 was marked by two distinct economic moments. The first one was characterized by recession in the Brazilian economy during the first quarter, with industry being most impacted by the crisis. The second one was marked by recovery in the three following quarters.

Recession was a global phenomenon, affecting not only emerging economies, but – and mainly – developed ones. However, the fact that the Brazilian economy returned to growth before most countries deserves special mention.

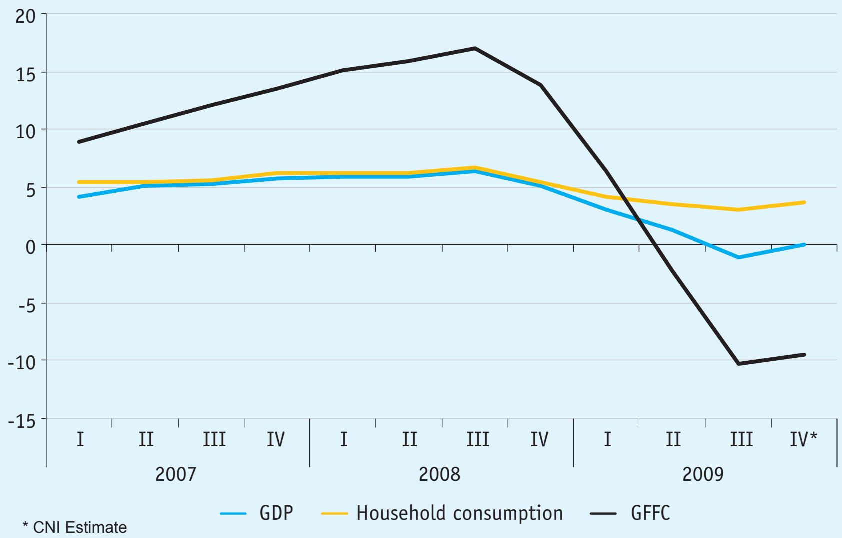
GDP decreased by 2.9% in the fourth quarter of 2008 and by 0.9% in the first quarter of 2009, in relation to the previous quarter – according to seasonally adjusted indicators – characterizing economic recession (declining GDP for two quarters in a row). Its negative effects on domestic production, however, became less intense as early as in the first three months of 2009.

This recessive scenario came to an end in the second quarter, when GDP grew by 1.1% in relation to the previous quarter. Economic recovery was consolidated throughout the year, and GDP increased by 1.3% in the third quarter on the same comparison basis.

**GDP, household consumption and gross formation of fixed capital**

Variation (%) accumulated in 4 quarters in relation to the 4 previous quarters

Impact of the crisis on investments was much more intense than on household consumption




* CNI Estimate
Source: IBGE

It should be emphasized that when it announced the results for GDP in the third quarter, IBGE (Instituto Brasilieiro de Geografia e Estatística) revised the seasonally adjusted data in such a way that the GDP drop observed in the fourth quarter of 2008 was seen to be less intense than previously announced (-3.4%) – as a result of a higher comparison basis in 2008. However, the data also shows that the current pace of economic recovery is slower.

Household consumption began to increase again in the first quarter of 2009 (by 0.4% in relation to the previous quarter). In the second and third quarters, household consumption grew by 2.4% and 2.0%, respectively (variations as compared to the previous quarter, according to the seasonally adjusted indicator).

Gross formation of fixed capital (GFFC) behaved very differently than household consumption. This indicator decreased by 11.0% in the first quarter and increased by 2.0% in the following quarter (seasonally adjusted data in relation to the previous quarter). Investments only began to grow again at a faster pace in the third quarter, when a 6.5% variation in relation to the previous quarter was observed. Data for October indicates that this trend will continue in the fourth quarter. In seasonally adjusted terms, capital good production grew by 5.9% in October as compared to the previous month (PIM-PF/IBGE).

A major change in relation to foreign trade is that the previous estimate of a positive contribution of 0.5 percentage point in GDP was revised in the light of the GDP result in the third quarter. CNI is now projecting a negative contribution of 0.3 percentage point as a result of an estimated drop of 12.0% in exports and of 8.0% in imports.

Lower idleness in the industrial complex has also encouraged new investment decisions. After decreasing by 4.3 percentage points – from 82.4% in October 2008 to 78.1% in January 2009 – the seasonally adjusted indicator for industry capacity utilization (CNI) rose in seven of the first ten months of 2009. In October, this indicator hit the mark of 80.5%. It should be stressed that this growth took place gradually, and capacity utilization is still 2.0 percentage points below the level registered in the same month the year before.

After falling sharply in the three last months of 2008 (-19.2% between September and December 2008), production in the manufacturing industry began 2009 on a recovery path and increased in all the first ten months of 2009 – according to the seasonally adjusted indicator as compared to the previous month. During this period, production in the manufacturing industry grew by 15.6%.

## Industry was particularly hit by the crisis

Despite a consistent recovery, the seasonally adjusted indicator for manufacturing production in October 2009 was still 6.6% lower than the one registered in the pre-crisis period (September 2008).

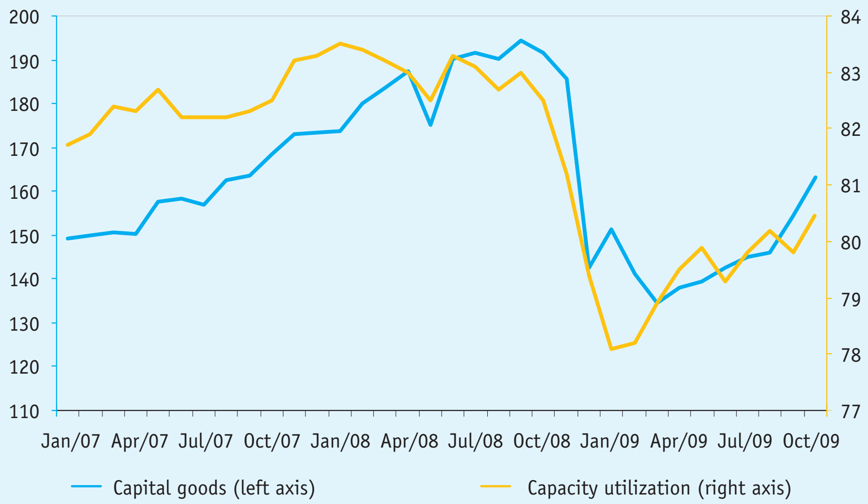
In sectoral terms, industrial production decreased in 21 sectors of the manufacturing industry plus the mineral extraction industry in the first ten months of the year in relation to the same period in the previous year. Sectors that are more exposed to the foreign market and those engaged in the production of durable goods – which are, therefore, more sensitive to credit flotations – were those that felt the negative impacts of the crisis most.

Government interventions to mitigate the effects of the crisis – such as suspension of the Tax on Industrial Products (IPI) for automotive vehicles, construction materials, and home appliances – were timely in leveraging recovery in these sectors. However, despite these measures, pre-crisis production levels in these sectors will only be exceeded next year, given the intensity of the crisis in industry.

**Capital goods production and capacity utilization**

Capital goods: Base 2002 = 100. Capacity utilization: in % - seasonally adjusted

Production of capital goods grows in the wake of capacity utilization increase




Source: CNI and IBGE

Only the Pharmaceutical, Other Transportation Equipment, Beverages, and Cleaning Products and Perfumes sectors experienced any growth in 2009.

## Recovery will not be sufficient to ensure GDP growth in 2009

Despite the economic recovery observed in the second and third quarters, GDP decreased by 1.7% in average in the first three quarters of 2009 as compared to the same period the year before. GDP drop on this comparison basis will only be reverted in the last quarter, when CNI expects to see zero growth in 2009. This forecast is based on an estimated increase of 5.1% in the fourth quarter in relation to the same quarter the year before.

On the supply side, industry will be the GDP component that will have the highest negative influence on economic performance in 2009. CNI estimate for industrial GDP in 2009 is -4.5%. Of the four components making up the industrial GDP, manufacturing is expected to slow down by 6.1%.

The civil construction industry seems to be recovering strongly after the critical period of the crisis. However, this performance will not be sufficient for this industry to make any progress in 2009. Therefore, CNI has maintained its estimate of a 5.7% drop in the

**Manufacturing production by activity sector**

Variation (%) accumulated between January and October 2009 in relation to the same period the year before

In most industrial sectors, production will only exceed pre-crisis levels (September 2008) in 2010


Source: IBGE

civil construction GDP this year. CNI estimates a 0.4% decrease in the extractive industry and a 0.5% increase in public-utility industrial services.

## As economic activity gathers speed, GDP will grow at a faster pace in 2010

If confirmed, the marked growth observed in the fourth quarter of 2009 will lead the Brazilian economy to begin 2010 on an acceleration path. There are many factors suggesting that GDP will grow by 5.5% next year. As the labor market recovers, jobs will once again grow at more robust rates in 2010. Jobs on the rise in a scenario of inflation under control will ensure a more intense increase in total earnings. These factors, added to the increased availability of credit for natural persons, will lead to a 5.6% increase in household consumption next year. Government consumption will in turn grow by 3.7% in 2010.

A unique feature of the Brazilian economy is that 2010 will be marked by a growth pattern exclusively sustained by household consumption and gross formation of fixed capital, considering that the contribution of the foreign trade sector will be negative. While most other countries will recover slowly – delaying the resuming of Brazilian exports – a higher purchasing power with an appreciated domestic currency will stimulate a more robust growth of Brazilian imports. CNI estimates that exports and imports will grow by 11.5% and 20.0%, respectively, according to the National Accounts methodology (IBGE).

On the supply side, the service industry (including retail trade, among other sectors) recovered from the international crisis back in the first quarter of 2009 and there are no signs that this trend will be discontinued. This positive performance is projected to become even more intense next year, ensuring a growth rate of 5.4% in 2010.

Manufacturing is only expected to exceed the levels observed before the crisis in the first half of the year. Undesired stocks of industrial products have already been adjusted to planned levels (Industrial Survey - Manufacturing and Mining/CNI), providing incentives to boost manufacturing production in the future. For this reason, industry will be the GDP component with the highest positive influence on economic growth in 2010 on the supply side: CNI estimates a 7.0% industrial GDP growth. For the manufacturing and civil construction industries, CNI estimates a growth of 7.5% and 5.0% next year, respectively.

It should be mentioned that heated economic activity is likely to be accompanied by more investments in production, as investments that were interrupted when the crisis broke out begin to flow again. Moreover, higher industrial business confidence combined with lower idleness in the industry will lead investments to be resumed.

Investments (GFFC), for which late signs of recovery were observed in 2009, will have a more dynamic behavior in 2010, more than reverting the drop estimated by CNI, namely, 10.8% in 2009. If this movement is confirmed, investments will once again grow at twice the rate of GDP (by 14.0% according to CNI estimates).

**GDP Estimate**

Percentage variation and contribution of GDP components

| | GDP Components | 2009 Growth Rate (%) | 2009 Contribution (in p.p.) |
|---|---|---|---|
| Demand | Household Consumption | 3.7 | 2.2 |
| | Government Consumption | 2.3 | 0.5 |
| | Gross Fixed Capital Formation | -10.8 | -2.1 |
| | Exports | -12.0 | -1.7 |
| | (-) Imports | -8.0 | -1.1 |
| Supply | Agriculture and Livestock | -4.0 | -0.3 |
| | Industry | -4.5 | -1.3 |
| | Services | 3.0 | 2.0 |
| | **GDP** | **0.0** | |

Prepared by: CNI

jobs and wages

# Jobs on a recovery path

The labor market dynamism, which led to a significant increase in formal jobs, was abruptly interrupted by the international crisis. Despite a deterioration in basic labor-market indicators – such as employment and labor force rates –, these behaved in a unique fashion during the crisis in 2009.

The labor market response to the crisis was clear. From November 2008 to April 2009, jobs decreased almost steadily in the six largest Brazilian metropolitan regions. In this period, 647,000 registered and unregistered jobs were lost. According to data for October 2009, metropolitan jobs dropped by 0.3% in relation to the same month of a year before – the first decrease in jobs since the beginning of the PME (Monthly Job Survey) series, in March 2002.

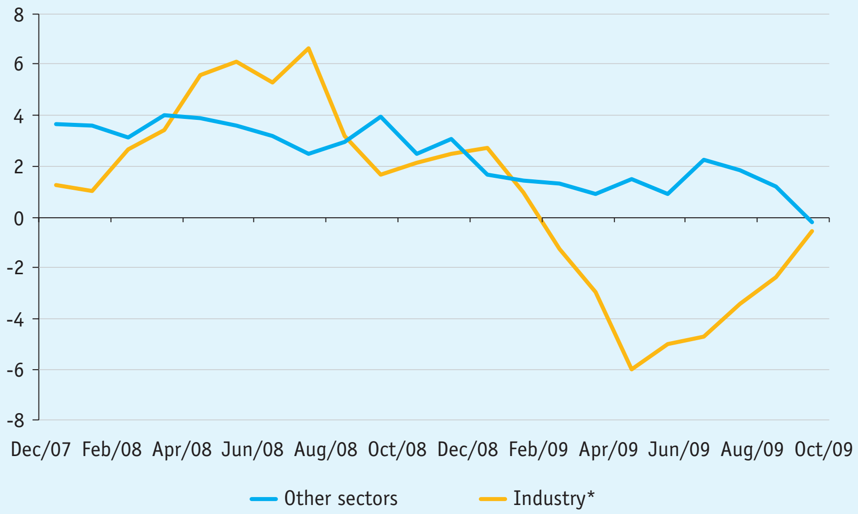
While the labor market in the trade and service industries was only mildly impacted, an intense and lasting reduction in jobs was observed in the industrial sector. Also with respect to the metropolitan labor market, industrial jobs, which had grown by 6.7% in August 2008, in relation to the same month the year before, dropped by 6.0% in May 2008.

Manufacturing jobs throughout Brazil (CNI Industrial Indicators) decreased for eight months in a row – from

**Occupation**

(%) Variation in relation to the same month the year before

Impact of jobs in industry differs from what was observed in other activity sectors




* Industry as a whole, except civil construction
Source: PME/IBGE

November 2008 to May 2009. The interruption in industrial job growth was preceded by a sharp drop in worked hours. The indicator decreased by 10.3% in the last quarter of 2008 – comparing the seasonally adjusted data for December with the ones for September.

## Jobs in industry recover heterogeneously in sectoral terms

In June, both the Monthly Job Survey/ IBGE and CNI Industrial Indicators revealed that manufacturing jobs initiated a recovery process. Despite this recovery, the seasonally adjusted indicator for industrial jobs (CNI) in October 2009 was still 4.0% below the one registered in the pre-crisis period (i.e. September 2008). For this reason, pre-crisis industrial job levels will only be exceeded in the middle of the first half of 2010.

In sectoral terms, jobs are still far from recovering as compared to the same month the year before. Only one sector grew in October 2009 as compared to the same month in 2008: Food and beverages (2.8%). Excluding the Chemical Products sector – in which job levels remained stable – the indicators for 17 other sectors considered in the survey are down in relation to the same month the year before. Of these sectors, the Wood (-16.1%), Electronic Materials and Communication Equipment (-13.8%), Primary Metal Products (-11.4%), and Automotive Vehicles (-10.7%) sectors were the ones that dropped most, by two-digit rates.

## Self-employment recovery in metropolitan regions deserves special mention

Registered jobs in the private sector, which led employment growth before the crisis – in October 2008 the indicator grew by 6.9% in relation to the same month the year before–, dropped by 0.3% in October 2009. This was the first decrease, on this comparison basis, since February 2004.

Unregistered jobs in the private sector, which grew by 0.9% in October 2008 in relation to the same month in the previous year, also dropped by 7.4%, in October 2009.

Self-employment, which had dropped by 0.4% in October 2008 and, after a recovery process, rose by 3.5% in October 2009, was the only form of metropolitan employment to grow in relation to the same month the year before.

The combination of different registered and unregistered employment dynamics maintained the labor market formality index – composed of the sum of registered, military, and statutory jobs divided by total jobs – at virtually the same level. The indicator passed from 56.5% in October 2008 to 56.6% in October 2009.

The impacts of the crisis were also significant on registered jobs throughout the country (CAGED/MTE). Job creation in the 12-month accumulated figure decreased from 2 million in October 2008 to only 468,000 in October 2009 – representing a net flow of new jobs of only 24% in relation to the previous year.

It should be stressed, however, that CAGED registered an increase in registered jobs in the first 10 months of 2009 that exceeded the most optimistic expectations, as over one million jobs were created during this period. The difference between formal jobs considered in CAGED and the ones considered in the PME is not only due to methodological aspects, but also to different job recovery dynamics between metropolitan and non-metropolitan regions – which are not considered in the PME.

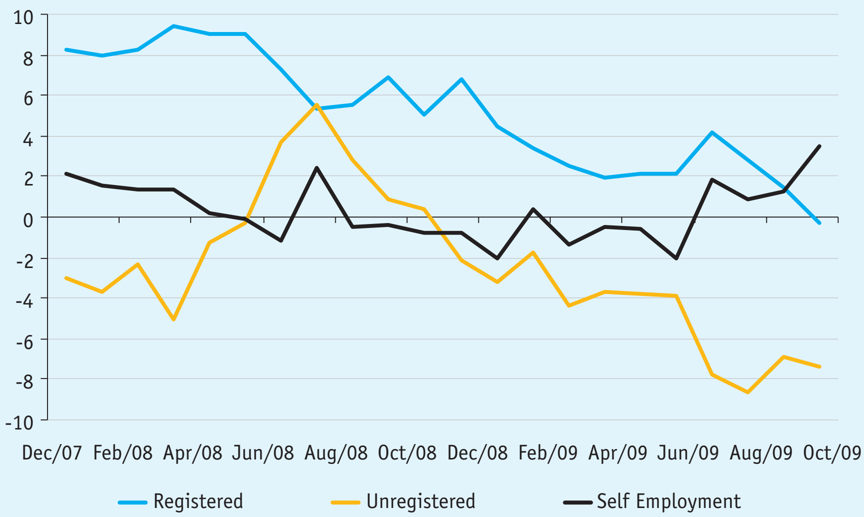
## Less intense job search reduces impacts on unemployment rate

Surprisingly, a marked decrease in job vacancies has not led to a significant increase in the unemployment rate as a result of the international crisis. The

**Variation of registered and unregistered jobs in the private sector and self-employment**

(%) Variation in relation to the same month the year before

Self-employment on a recovery path



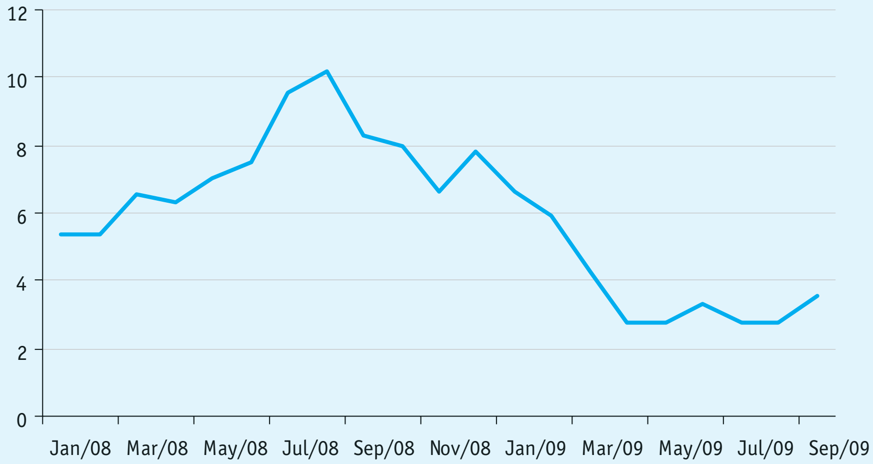

Source: PME/IBGE

indicator grew less than expected in the first quarter of 2009 – less than 1.0 percentage point (p.p.). In the months that followed, it began to drop at a relatively fast rate and hit the mark of 7.5% in October 2009 (as in the same month in 2008). A less intense job search allowed for the unemployment rate to have a positive performance in 2009. Labor force decreased by 682,000 individuals in the last 12 months (up to October), characterizing the highest decrease in labor force in a 12-month period since the beginning of the PME series. CNI estimates that the average unemployment rate will hit the mark of 8.1% in 2009.

**Real metropolitan total earnings**

(%) Variation in relation to the same month the year before

Total earnings continued to grow, but at a slower pace




Source: IBGE.

## Total earnings continued to grow in 2009, but at lower rates

Total earnings loose momentum, when rate growth decreased from 10.2% in August 2008 to 3.6% in September 2009 – in relation to the same month the year before. Despite that behavior, the fact that total earnings did not drop in the annual comparison helped sustain household consumption.

The combination of higher nominal incomes and lower inflation rates ensured an increase in real total earnings in 2009. The percentage of wage negotiations (Dieese) with adjustments equal to or higher than the inflation rate – as measured by INPC/ IBGE – was close to 93% in the first half of 2009, characterizing higher real-term wage adjustments as compared to the 87% of negotiations of raises equal to or above inflation in the same period the year before.

The cash transfer policy of the Brazilian government has also played a key role in sustaining domestic consumption. As a result of the high consumption propensity of low-income families, the amount transferred to these families was instantly injected in the economy.

## Prospects for a more dynamic labor market

Labor market is already on a recovery path. Job generation is likely to become more intense in 2010, with positive impacts on total earnings, which may grow at a rate in excess of 5.0% in 2010 – one of the pillars of economic growth next year.

In this context, CNI expects the labor force to grow again in 2010 – contrasting with the drop registered in 2009 –, making further decreases in the unemployment rate unlikely. This indicator is projected to register a 7.6% average annual rate next year.

inflation, interest rates, and credit

# Crisis was deflationary in nature in 2009

The international crisis slowed down price rises in Brazil. While other world crises ended up increasing inflation rates, the one being faced now contributed to placing Brazilian inflation, which hit the mark of 6.4% a year in November 2008, back at the center of the 2009 goal (4.5% a year).

Although this is a positive fact from the point of view of inflation control and expectations, it resulted from two structural factors: Brazilian exports' dependence on agricultural commodities and the strong impact of the crisis on foreign credit sources and on the country's industry.

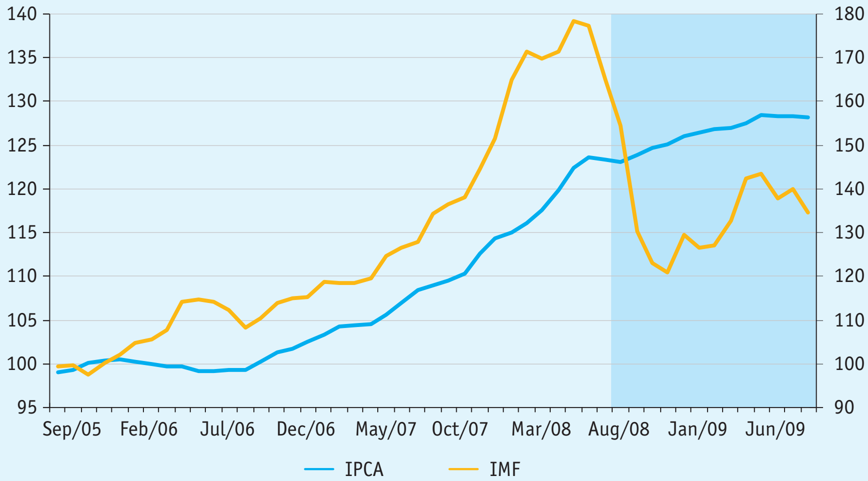
On the commodity side, the international prices of food products, which account for a major part of Brazilian exports, have dropped substantially. According to an index calculated by the IMF, there was a 32.3% reduction between the highest international food and beverage prices (June 2008) and the lowest ones (December 2008).

The domestic prices of these goods were affected in different ways. Food prices in Brazil dropped less than those registered in the international market, but their growth rates were much lower than the ones observed in recent years. As a comparison,

**Price indices for Food and Beverages according to the Extended Consumer Price Index (IPCA) (axis on the left) and to the IMF (axis on the right)**

2005 Average = 100

Food and beverages prices slowed down in 2009




Source: IBGE and IMF

the food and beverages group of the Extended Consumer Price Index (IPCA) accumulated a 10.8% and 11.1% hike in 2007 and 2008, respectively. From January to November 2009 (last data available), in turn, the hike amounted to only 2.9%.

## Governmental measures affected IPCA results

The modest increase observed in the prices of industrial product was basically determined by the strong impact of the crisis on the sector and by tax exemption measures applied by the Government to address these effects.

The crisis had two different impacts on prices: initially, during the most acute phase of the crisis, production decreased due to credit restrictions and to a lower domestic and foreign demand. For this reason, companies adjusted their stocks in order to increase their revenue and keep stocks rolling, thus generating a positive supply shock. As a result, the prices of these goods dropped.

In a second moment, as the domestic situation improved, mainly in the second half of the year, prices were not pushed up by the revival of domestic demand. The return of foreign capital (which had left the country when the crisis broke out) brought about a significant appreciation of the domestic currency, making the prices of imported products more competitive in relation to those of domestic products. Therefore, as a result of the competition of imported products, no significant increase in the prices of industrialized products was registered.

Tax exemption measures also contributed to this scenario. Reductions in the Tax on Industrial Products (IPI) for automotive vehicles, home appliances, and construction materials led to a direct pass-through to final product prices. For example, new cars accumulated a 3.8% drop in the year (up until November) - the greatest negative contribution to the IPCA. The electronic appliances group dropped by 3.5% in the year. On the other hand, an increase in the IPI applied to cigarettes to offset revenue losses caused by tax exemptions contributed positively to the IPCA. The index increased by 27.0% in the year.

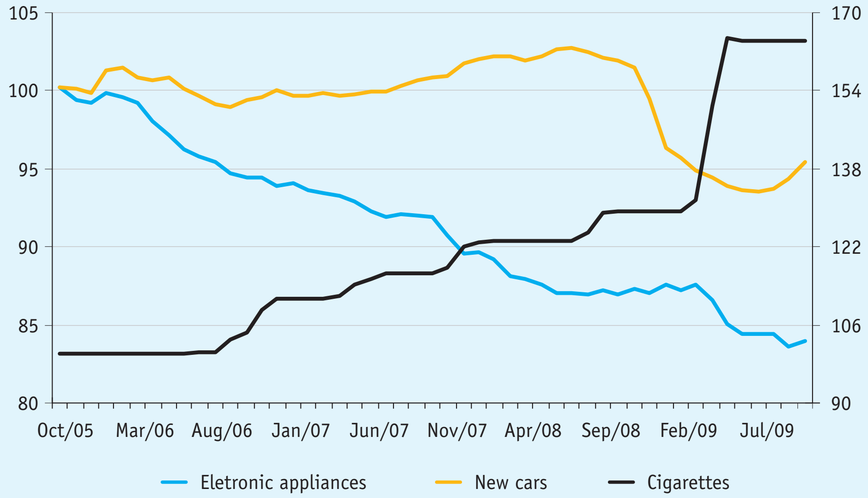
## Food prices will rise until the end of the year

The 12-month accumulated IPCA followed a downward path throughout

**Price indices for electric and electronic appliances, new cars (axis on the left), and cigarettes (axis on the right)**

2005 Basis=100

Governmental measures affected components of the Extended Consumer Price Index (IPCA) in different ways

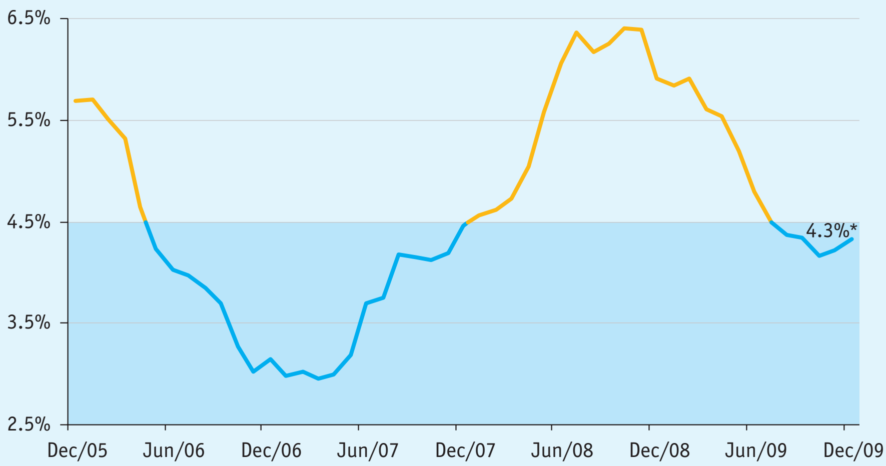



Source: IBGE

**Evolution of the official inflation rate (IPCA)**

12-month accumulated percentage

IPCA will close 2009 below the center of the target




* CNI Estimate
Source: IBGE

2009 and, as a result, the indicator hit the center of the target in July. Just service prices, which kept increasing throughout the year, prevented a faster convergence. While the prices of industrial and food products increased, by 2.4% and 2.9% up until November respectively, service prices grew by 6.1% in the same period.

Government-managed prices, in turn, suffered the impacts of IGP-indexed contract renewals. Until November, they dropped by 4.2%. Despite the positive scenario, this trend is not likely to continue in 2010, as the General Price Index (IGP) has been more strongly affected by the deflationary effects of the crisis. During the year (up until November), the General Market Price Index (IGP-M) accumulated a 1.5% deflation and is expected to close the year with a negative figure.

The inflation scenario in 2009 is favorable. Industrial prices are not expected to increase significantly until the end of the year mainly due to the appreciated exchange rate, which makes the prices of domestic products less competitive in relation to those of imported goods. Government-managed prices are likely to increase to some extent, mainly public transportation prices, while service prices are projected to increase moderately as the year comes to an end, with adjustments in medical and hospital services, courses, and school fees. Food products, in turn, are likely to push the IPCA up, as they tend to increase seasonally in year-end celebrations. Therefore, CNI estimates that the 2009 inflation rate, as measured by the IPCA, will hit the mark of 4.3% a year.

## Controlled Inflation and credit restrictions result in a one-digit Selic rate

Copom decisions in 2009 were based on the recessionary effects suffered by the Brazilian economy early this year and on a rapid IPCA convergence to the center of the target.

In the most acute phase of the crisis (first half of the year), an interest rate reduction policy was implemented with the aim of stimulating the revival of credit in the country. Between January and July, the Selic rate dropped by 4.00 percentage points, from 13.75% to 8.75% a year. As a result, the basic interest rate is at a one-digit level for the first time.

In the second half, as economy began to show the first signs of recovery and IPCA dropped less intensely in the 12-month accumulated figure, the interest rates remained the same, at 8.75% a year, with an average annual rate of 10.13% a year. The real interest rate is in turn expected to close 2009 at 5.0% a year, against 6.4% a year in 2008.

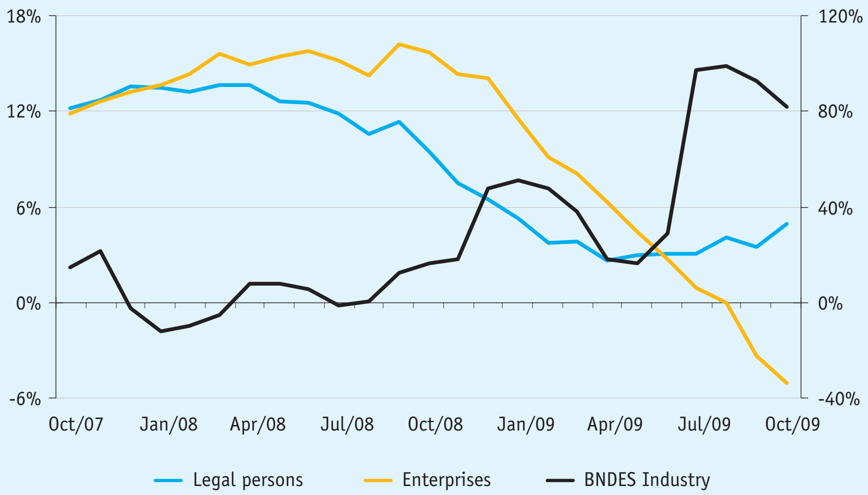
## Credit for companies deteriorated in 2009

Although reductions in the Selic rate during the year contributed to make more credit available in Brazil, it is

**Grants of non-earmarked resources to persons and enterprises (axis on the left) and of BNDES resources to industry (axis on the right)**

Average in the last 12 months against the same month in the previous year

Private credit for enterprises was replaced by public credit

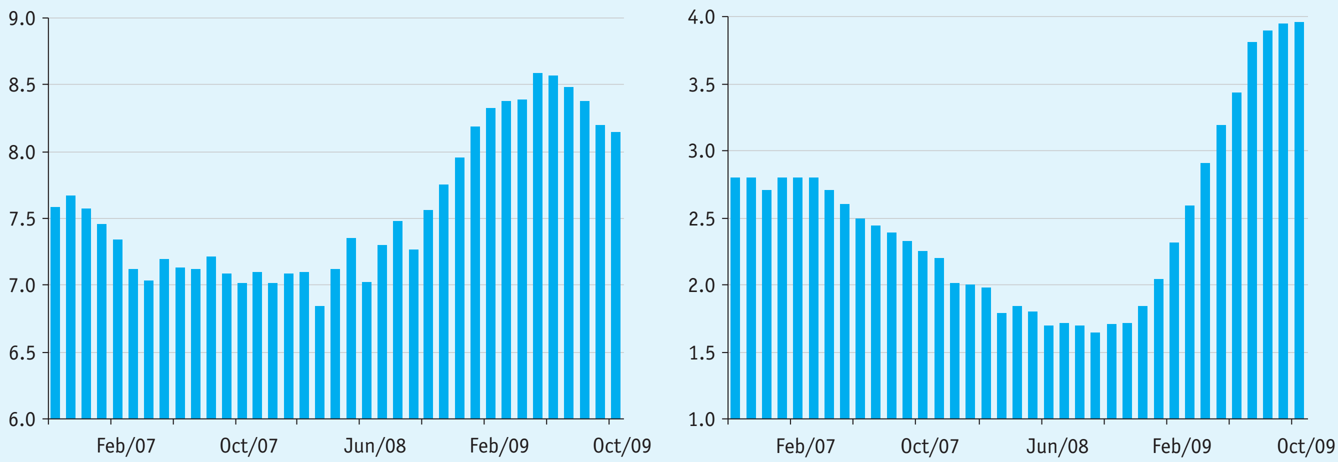



Source: Central Bank of Brazil and BNDES

**Repayment delay for more than ninety days for persons (left) and enterprises (right)**

% of total credit

Default rate among enterprises is likely to drop over the next few months




Source: Central Bank of Brazil

still affected by structural problems as compared to 2008. With the crisis, banks reduced loans with funds of their own and increased their spread. This was mainly due to a higher default risk, as observed in other countries. Credit became scarcer and more expensive.

This restriction was experienced in different ways by persons and enterprises. While credit for individual borrowers was not deeply affected, new loans to enterprises dropped sharply. One year after the crisis broke out, credit for individual borrowers is on a strong recovery path already, while credit for companies is not recovering with the same vigor.

To make up for this credit shortage, enterprises started to resort to official sources such as the National Economic and Social Development Bank - BNDES. As a mean to fight the credit crisis, the government increased the resources made available by the bank and created new emergency credit lines, such as floating capital credit lines for companies. Credit with private funds (of financial institutions) was thus partly replaced by public credit.

## Default rate of enterprises stabilizes

Despite fears of higher default rates, the effects of the crisis were less intense than expected. The default rate of both persons and enterprises did increase, but it will not increase any further.

According to Central Bank data, the percentage of repayments in delay for more than 90 days (default indicator) among persons, which hit the mark of 8.59% in May 2009, has been dropping since then. In October, this indicator was 8.14%, still higher than the lowest percentage of the series (6.85% in March 2008). The same indicator for enterprises, which amounted to 3.96% in October (last datum available), has not changed much since July. It should be mentioned that while the default rate among persons kept dropping since the first half of the year, the one for enterprises stabilized and has not yet resumed an upward path.

This is a positive result, mainly because the default rate is used as a basis for granting credit. Comparing the credit-granting graph with the one for repayments in delay for more than 90 days, it can be seen the credit for persons recovered at the same pace of the drop observed in the default rate. For this reason, as the default rate for enterprises stabilizes and begins to drop in the future, banks are likely to once again grant credit with funds of their own.

Spreads will also follow this trend, considering that their main component (default) will drop in the next few months. In October, the credit spread for enterprises is stable, but still substantially higher than the Selic rate, while in other periods the two rates were more similar.

## What can be expected in 2010

2010 will be the year in which industry will leave the crisis behind, paving the way for a solid growth. As a result, the dynamic of prices will also be different than in 2009. The trend observed in 2009 will be inverted, with prices charged for services and government-managed prices increasing less and those of industrial products increasing moderately. Prices in the Food group will be the ones that will increase most.

On the one hand, higher capacity utilization will increase the supply of industrial products, in tune with a higher domestic demand. This price hike scenario will be partially offset by the continued appreciation of the real, as industrialized products will suffer competition from imported products.

Government-managed prices are likely to increase less than in 2009, mainly because of the General Price Indexes (IGP's) results observed this year. Service prices, which kept increasing throughout the year, are likely to increase less than in 2009. Food prices are expected to increase in tune with the end-of-year trend. This movement will be driven by the revival of foreign demand and the recovery of international agricultural commodity prices.

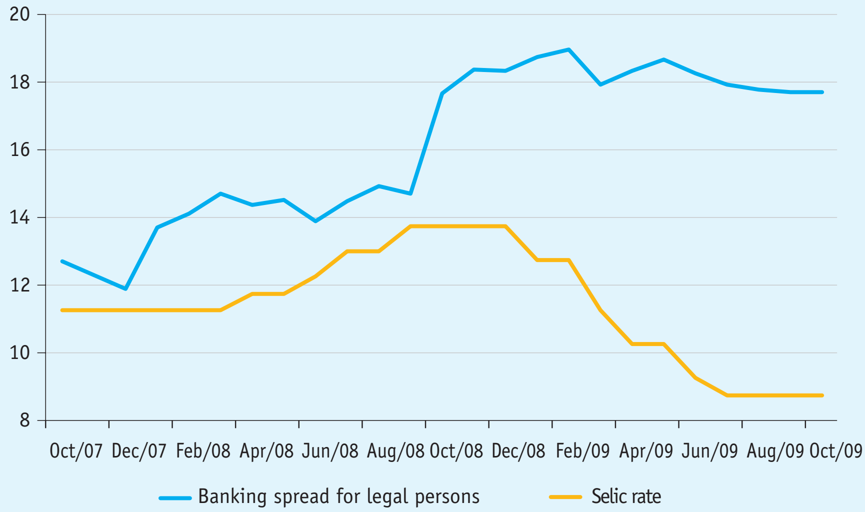
Despite the price hike for food products, a controlled price increased for other IPCA components will keep food prices close to the inflation target in 2010. With a scenario of inflation under control, there is no need to raise the Selic rate.

For this reason, CNI estimates that the IPCA will close 2010 at 4.7% a year (a little above the center, but still within the inflation target of 4.5% a year), and the Selic rate will remain unchanged throughout the year at 8.75% a year. With inflation under control in 2010 and a stable Selic rate, the real interest rate will be lower than in the previous year, closing 2010 at 4.3% a year.

**Banking spread for legal persons and Selic rate**

% a year

Downward trend in spreads expected in the next few months




Source: Central Bank of Brazil

fiscal policy

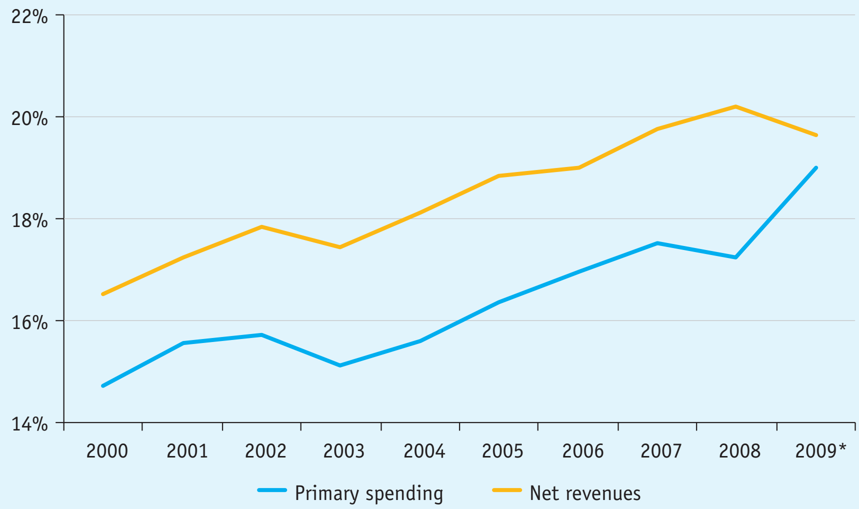
# Expansionist fiscal policy was designed to reduce the impacts of the economic crisis

Fiscal policy tools were actively used to curb the impacts of the economic crisis. The Federal Government granted tax exemptions and increased its spending with defrayal and investments. In addition, it maintained previous decisions that led to marked increases in spending, such as raises in the minimum wage and in the salaries of civil servants. Regional governments also experienced fiscal expansion by keeping the same spending levels while revenues decreased. The result of this expansionist fiscal policy was an increase in the nominal deficit from 2.0% to 3.7% between 2008 and 2009.

**Evolution of Federal Government primary spending and net revenues**

Accumulated in the year (% of GDP)

Primary spending increases by 1.8 p.p. of GDP and net revenues drop by 0.5 p.p. of GDP as compared to 2008




Source: National Treasury - STN/Ministry of Finance - MF

Note: The figures for November 2008 and December 2008 were estimated by CNI.

Primary spending of the Federal Government grew by 10.9% in real terms (IPCA deflator) between January and October 2009 in relation to the same period in 2008. Although all the main spending components increased significantly, special mention should be made of a real increase of 13.1% in expenditures with defrayal and investments and of 12.8% in spending with staff.

Because spending is projected to grow much more than the economy at large in real terms, Federal Government primary spending will increase sharply in relation to GDP, from 17.2% in 2008 to 19% in 2009.

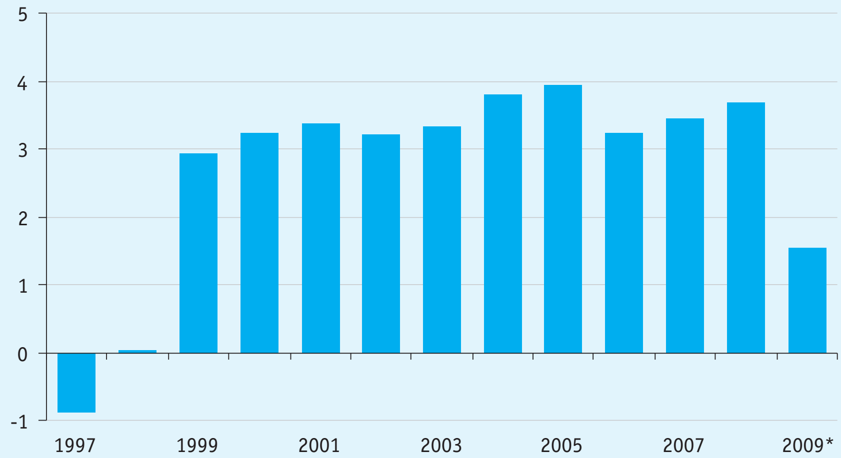
A higher public spending in moments of economic slowdown is positive – a movement referred to as anticyclic fiscal policy. However, the fiscal policy implemented in 2009 and, for that matter, in recent years raises concerns as to the prevalence of increases in current spending, which are mostly compulsory in nature. What this means is that it will not be possible to reduce them after the economy resumes a growth path.

Primary spending of the Federal Government increased by R$ 45.6 billion (at October 2009 prices) in a comparison between January-October 2009 and the same period in 2008. Current spending increased by R$ 42.6 billion (or 93.5% of total spending), while investments grew by only R$ 3.0 billion.

While on the one hand there was a sharp increase in spending,

**Evolution of the Public Sector primary surplus**

Accumulated in the year (% of GDP)




Source: Central Bank of Brazil

Note: The figure for 2009 was estimated by CNI.

Primary surplus is expected to drop by 2.1 p.p. of GDP and hit the lowest mark in 11 years

the Federal Government faced a significant drop in its tax revenue on the other. The net Federal Government revenue decreased by 5.5% in real terms between January and October 2009 in relation to the same period in 2008. Its net revenue is therefore expected to hit the mark of 19.7% of GDP in 2009, against 20.2% at the end of 2008.

Two factors explain this behavior of revenues: tax exemptions granted by the Federal Government and lower activity levels and profitability of enterprises as a result of the crisis. We estimate that tax exemptions reduced the net Federal Government revenue by R$ 8.3 billion in 2009.

Regional governments also experienced a real drop in revenues. Total revenues of states and municipalities from their main sources decreased by 2.9% between January and October 2009 in relation to the same period in 2008. This decrease was mainly attributed to tax exemptions granted by the Federal Government and to the economic slowdown, which led to a 3.5% decrease in the ICMS (Value-Added Tax) collection. According to our estimates, these tax exemptions reduced constitutional fund transfers from the federal to regional governments by R$ 5.1 billion.

As opposed to what was observed in the federal administration, the spending of regional governments dropped sharply in relation to 2008 (15.8%). We believe that spending between January and October 2009 will be stable (in real terms) in relation to the same period in 2008. Due to the restraints imposed by the Fiscal Responsibility Law and by debt renegotiation agreements with the Federal Government, regional governments faced stronger pressures to reduce their spending once their revenues decreased.

## Primary surplus drops sharply in 2009

The revenue drop experienced at the three governmental levels and the higher spending of the Federal Government will lead to a significant decrease in the primary surplus in 2009 in relation to the previous year. CNI estimates that the public sector will close the year with a primary surplus of 1.55% of GDP, against 3.7% of GDP in 2008.

Although the primary surplus target for 2009 was reduced from 3.3% to 2.5% of GDP, the Federal Government can deduct up to 0.94% of GDP (R$ 28.5 billion) in investment spending contemplated in the PAC (Growth Acceleration Program) from that target. As a result, a 1.55% primary surplus can still be in tune with the target if this spending with the PAC is achieved.

The Federal Government primary surplus is likely to amount to 0.7% of GDP. Although the original target was 1.4% of GDP, the possibility of deducting PAC investments (0.94% of GDP) makes it possible for the estimated percentage to exceed the 0.46% of GDP requirement.

The increase expected in the Federal Government primary surplus is due to a delayed return of taxes withheld and the inclusion of judicial deposits in the category of revenues in the last months of the year. In addition, it will not be possible to pay out all budget assignments to non-compulsory spending up until the end of 2009.

If the Federal Government exceeds the primary surplus target, this will make up for the 0.1% of GDP primary deficit that federal state enterprises are expected to experience. This result will be much lower than the 0.2% of GDP primary surplus target.

For regional governments and their enterprises, we are projecting a primary surplus of 0.9% of GDP. Therefore, despite the decrease in relation to the 1.1% of GDP result achieved in 2008, states and municipalities are still likely to fully comply with the target set for 2009.

As a result of a lower public sector primary surplus, there will be a significant increase in the nominal deficit, namely, 3.75% of GDP in 2009 against 2.0% in the previous year. This will occur regardless of a lower spending with interest payments, which is likely to hit the mark of 5.3% of GDP in 2009, against 5.7% in 2008. Despite these lower interest payments both on over-Selic-indexed securities and on fixed-income securities, the rising indebtedness observed throughout the year reduced their positive impact on interest spending.

A higher nominal deficit, a modest GDP nominal growth, and the exchange rate appreciation will lead to a significant increase in the public debt. The net debt/GDP ratio is likely to rise from 38.8% in 2008 to 43.4% in 2009.

The impact of the exchange rate appreciation on the public sector net debt deserves special mention, as it could be as strong as that of a higher nominal deficit. Since the public sector's external assets exceed the foreign public debt by a large margin, the exchange rate appreciation led to a sharper drop in external assets than the one observed in the foreign public debt denominated in the domestic currency.

## Fiscal indicators likely to improve in 2010

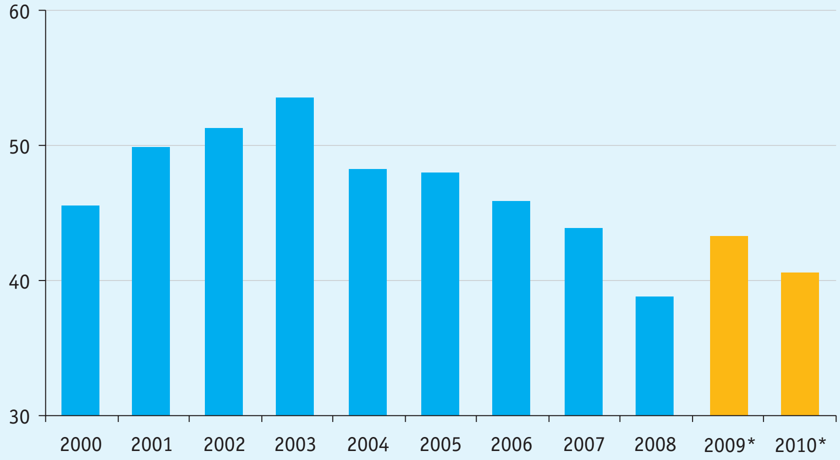
The fiscal scenario is likely to improve significantly in 2010 despite a new increase in Federal Government spending. The Annual Budget Bill (PLOA) provides for a 6.0% increase in primary spending in real terms in 2010 in relation to 2009. An increase in excess of 10.0% in net revenues is expected to make up for this higher primary spending.

CNI projects a different behavior for revenues than the one anticipated in the PLOA. Since the PLOA was submitted to Congress, the Federal Government granted new tax exemptions that will remain in force until 2010. In addition, the economic growth projected for 2009 (1.0% in real terms) should not be realized. On the other hand, the economy will grow more in 2010 in real terms than anticipated when the PLOA was prepared (4.5%).

Therefore, we estimate a 8.2% real growth in the net revenue of the Federal Government in 2010 in relation to 2009. The net revenue will thus hit the mark of 20.2% of GDP in 2010, against 19.7% in 2009. This expansion will be determined by the resumption of economic growth in real terms (estimated at 5.5%) and by the lesser impacts of tax exemptions on the tax revenue. In addition, we believe

**Path of the Public Sector Net Debt in relation to GDP**

Accumulated in the year (% of GDP)




Source: Central Bank of Brazil

Note: The figures for 2009 and 2010 were estimated by CNI.

After rising by 4.6 p.p. in 2009, public debt is likely to resume a downward path in 2010

that the growth pace of revenues will once again exceed GDP growth, as observed in the years before the economic crisis.

Also on the spending side, some budgetary assignments contemplated in the PLOA seem to be inadequate. We anticipate a higher spending with some components, such as with social security, since benefits exceeding one minimum wage will be raised in real terms.

Considering our scenarios for revenues and spending, the primary surplus target of 2.15% of GDP in 2010 will only be achieved if the Federal Government reduces the primary spending contemplated in the PLOA by R$ 64.9 billion. This will be a difficult reduction, since it represents a substantial percentage (37%) of non-compulsory spending provided for in the PLOA.

We expect the Federal Government to use a mechanism contemplated in the Budget Guidelines Law that allows for the target to be reduced by 0.7% of GDP in spending with PAC investments. In this case, the required spending cut would amount to R$ 42.3 billion. Although it is much higher than the first financial programming in 2009 (R$ 21.6 billion), we believe it is feasible, given the sharp increase in non-compulsory spending anticipated in the PLOA. In this scenario, the Federal Government primary spending will be reduced from 19.0% of GDP in 2009 to 18.8% in 2010.

Federal state enterprises constitute the main uncertainty in relation to the primary surplus target in 2010. In the past three years, the highest surplus registered in these enterprises was one of 0.1% of GDP in 2008. The Federal Government might have to exceed its primary surplus target to make up for not meeting the target set for federal state enterprises (0.2% of GDP).

In the case of regional governments and their enterprises, we believe that the surplus target of 0.95% of GDP will be achieved.  In this case, the consolidated public sector primary surplus anticipated for 2010 will hit the mark of R$ 86.9 billion, or 2.6% of GDP projected by CNI. With this result, the primary surplus target (3.3% of GDP) will be achieved by the public sector if PAC investments amounting to 0.7% of GDP are deducted from that target.

With a higher primary surplus in relation to 2008 and because we expect spending with interest rates to drop further to 4.5% of GDP in 2010, the nominal deficit would decrease to 1.9% of GDP. With a lower nominal deficit and a more intense GDP growth, the net debt/GDP ratio would drop to 40.5% of GDP at the end of 2010.

foreign trade sector

# Brazilian foreign trade impacted by the international crisis

## Appreciated real is the main concern of industry

The appreciating trend of the Brazilian currency has become a major concern for the Brazilian industry in the end of 2009 and it will be also in 2010. The post-economic crisis world will be characterized by fiercer competition in markets and the Brazilian currency appreciation exposes competition difficulties not only in exports, but also between imported products in the domestic market.

Up until November 2009, the real had appreciated by 27% in relation to the US dollar, 20% in relation to the euro, 26% relative to the Japanese yen, 19% in relation to the British pound, and 35% relative to the Argentine peso. In the same period, the Brazilian currency appreciated by 15% as compared to a basket of currencies of Brazil's main trade partners.

Central Bank figures show that the entry of foreign currencies plays a key role in pushing the Brazilian currency up. Between April and November, the net entry of foreign currencies amounted to US$ 29.4 billion, after a period of successive exits between October 2008 and March 2009 (except February), which totaled US$ 22 billion, meaning that the net entrance of foreign currencies in 2009 exceeded the exit caused by the crisis.

The US interest rate is still very low, stimulating indebtedness in that currency for investing in currencies that yield higher interests, such as the Brazilian real (the so-called carry trade). In addition, Brazil has been recognized as one of the best performing countries during the crisis: jobs in Brazil, for example, were much less affected than in other countries and domestic demand kept growing. This differentiation is reflected in higher foreign investments and in a more pronounced entry of foreign currencies to the country.

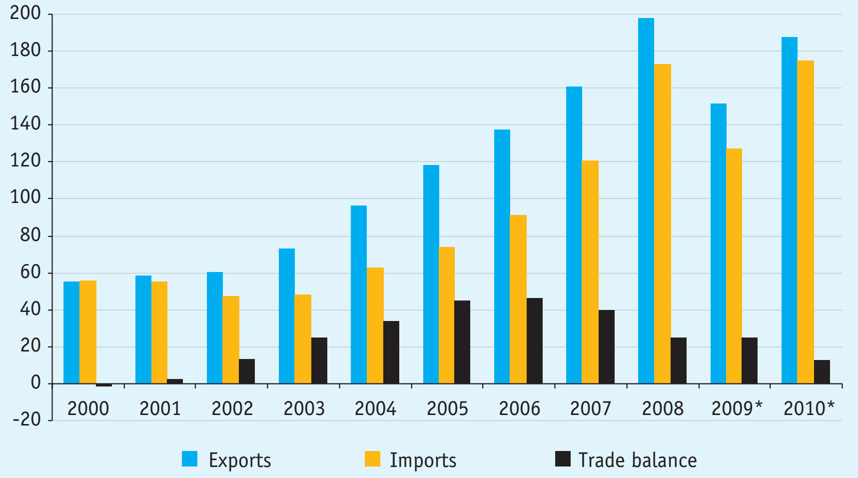
## Exports are recovering, albeit slowly

2009 will be the first year since 2002 in which the Brazilian annual trade

**Evolution of the Brazilian foreign trade**

In US$ billion

In 2009, exports will drop for the first time in the decade




* CNI Estimates
Source: Secex/ MDIC

flow decreased in relation to the year before. The year was characterized by a marked decline in the Brazilian foreign trade. The international crisis led to a strong reduction in foreign demand and export prices, while economic slowdown in Brazil reduced external purchases. The Brazilian trade flow decreased by 24.3% in the past 12 months (ending in November) as compared to the previous 12 months.

Brazilian exports dropped to 2007 levels. In the year up until November, exports amounted to US$ 139.4 billion, or 22.9% less than in the same period in 2008. In the 12-month accumulated figure, exports remained on a downward path all year round. The same scenario is expected in December, so exports are likely to close the year at about US$ 152 billion, 23.1% less than in 2008.

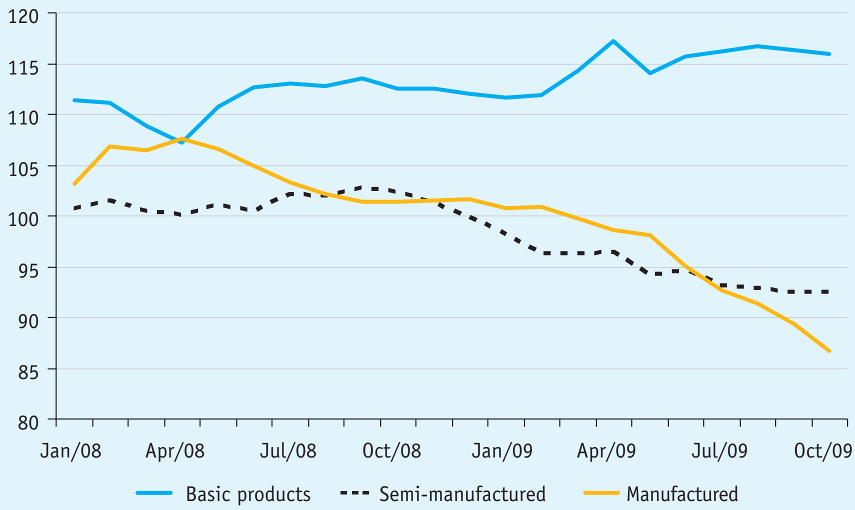
The lower exported value in 2009 is attributed to both prices and quantities. According to Funcex, export prices dropped by 15% in the year up until October, while the exported quantum decreased by 12%.

Prices in all product categories are lower than the ones registered in 2008. The prices of basic products dropped by 19% in the year, while those of semi-manufactured and manufactured products declined by 23% and 7%, respectively. Although prices are lower than the ones charged in 2008, their performance was positive in recent months. After dropping to their lowest levels in May, export prices of basic, semi-manufactured and manufactured products increased in the months that followed, rising, respectively, by 10%, 20% and 5% until October.

**Volume of Brazilian exports by product category**

Base: 2006 average = 100

Drop in exported volume of industrialized products was observed before the economic crisis broke out




Source: Funcex

In terms of volume, the poor performance of exports is explained by industrialized products. The exported quantum of manufactured products dropped sharply: 26% in the year until October. Albeit less, the exported volume of semi-manufactured products also decreased, by 8%. The exported volumes of basic products grew by 4% in turn.

Competitiveness losses led traditional partners of Brazil in the sale of industrialized products to lose importance in the export market. Between 2008 and 2009 (up until November) the sales to the United States and the European Union dropped by 43.7% and 27.1%, respectively. On the other hand, exports to China, a country that has become Brazil's main trade partner and is a major destination for basic products, grew by 21.6% during the same period. The country's share in exports rose from 8.5% in 2008 to 13.6% in 2009. During the same period, the US share decreased from 14.1% to 10.4%.

## Drop in manufacturing activity reduced imports

Like most countries, Brazil's imports decreased in 2009, totaling US$ 115.3 billion up until November. As observed for exports, 12-month accumulated imports have been on a downward path since the beginning of the year. This trend is likely to continue in December, and imports are expected to total US$

127 billion at the end of 2009, 26.7% less than in 2008.

Imports decreased as a result of lower prices and quantities. The imported volume decreased by 18% until October. Prices dropped by 8% in the same period.

In terms of prices, the drop was significant for fuels (45% until October). For other product categories, price variations were not very significant, ranging from a 5% drop for intermediate goods to a 1% increase for durables.

As for imported volumes, a general decrease was observed in all use categories. Intermediate goods dropped more significantly until October: 28%. Imports of capital goods, fuels and durables also dropped significantly: by 15%, 13% and 10%, respectively. Although the appreciation of the Brazilian currency is boosting imports, the sharp reduction observed in manufacturing and investments, apart from a lack of credit particularly early this year, explains why external purchases have dropped.

The drop in the imported volume was less significant for non-durable consumer goods, only 2%, as they are less dependent on credit and not so much related to manufacturing activity, but rather to household consumption, which was less impacted by the international crisis.

The fact that a trend of replacing domestic raw materials with imported ones was resumed deserves special mention. This trend had been interrupted when the crisis broke out, late in 2008, but is being quickly resumed in the end of 2009. While manufacturing production grew by 26% between April and October (PIM-PF/IBGE), imports of intermediate goods increased by 58%.

## Current account deficit decreases in 2009

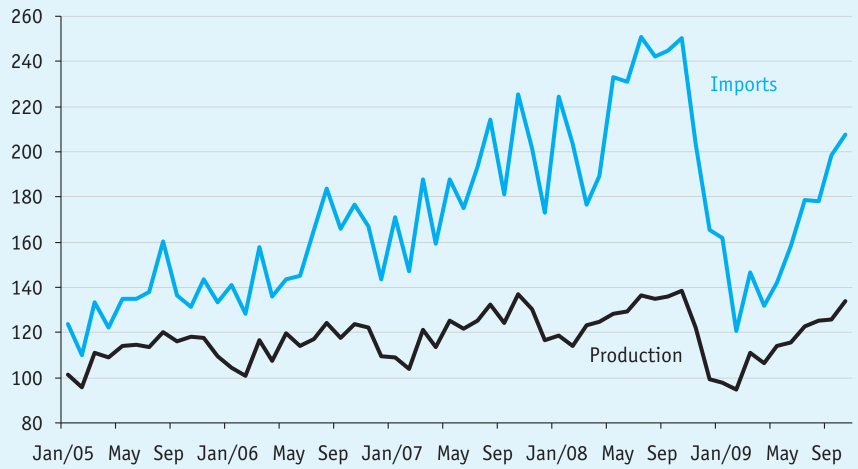
The trade balance until November amounted to US$ 23.2 billion, 3.5% more than in the same period in 2008. The balance in current transactions accumulated a deficit of US$ 14.8 billion until October and is likely to close the year at US$ 20.1 billion. It dropped by 29% as compared to 2008.

The current account gap declined particularly due to a deficit in services and income. The 12-month accumulated deficit decreased from US$ 26.9 billion in January 2009 to US$ 18.8 billion in October. The deficit dropped sharply early this year – particularly as a result of a lower distribution of profits and dividends as compared to 2008. At the end of the year, however, the

**Imports intermediate products and production in the manufacturing industry**

Base: 2002 average = 100

Purchases of imported raw materials responded rapidly to resuming of economic activity




Source: PIM-PF/IBGE and Funcex

deficit resumed a growth path: the appreciation of the real is encouraging Brazilians to spend abroad.

## Imports will grow at a fast pace in 2010

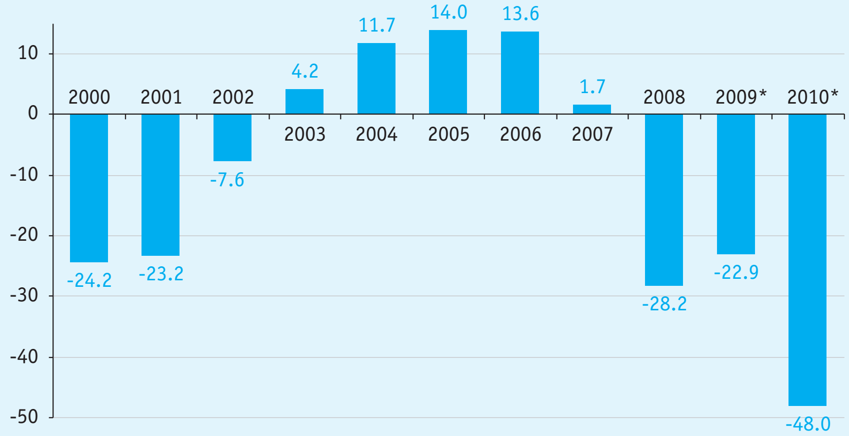
The Brazilian currency appreciation will continue to be a problem to be faced by industry in 2010. Various factors stimulating the appreciation of the real will continue to push it up. On the other hand, the government has repeatedly expressed concerns over the exchange rate path and is considering measures to curb or even invert this appreciation. We believe that the government will try and curb this appreciation, but it will not manage to avoid it completely. The exchange rate is likely to close the year in 2010 at about R$ 1.70 / US$ 1.

As in 2009, economic growth in Brazil is likely to exceed international economic growth in 2010. Imports will gain momentum; purchases of intermediate goods will continue on an upward path as a result of a continued process of replacing domestic raw materials with similar imported ones. Throughout the year, this growth will be accompanied by greater purchases of capital goods resulting from resumed investments. An appreciated real will also boost purchases of consumer goods. As a result, imports will grow strongly, totaling US$ 175 billion in 2010, 38% more than in 2009 and more than in 2008 even.

**Current account surplus**

In US$ billion

Current account surplus likely to hit the mark of 2.5% of GDP




* CNI Projection

Source: Central Bank of Brazil

On the other hand, exports will also grow in 2010, particularly due to price gains, as prices are likely to remain on the upward path observed in the last months of 2009. Exports to different destinations will increase in general, particularly to developing countries, as manufacturing activity in developed countries will recover more slowly. Exports are expected to total US$ 188 billion in 2010, 24% more than in 2009, but still less than in the pre-crisis period. With the figures estimated for exports and imports, the trade balance in 2010 is projected to hit the mark of US$ 13 billion.

In a scenario of intense economic growth in Brazil, spending is expected to increase not only with imports, but also as a result of the deficit in services and income, which will be only partially offset by increased investments. As a result, we expect the current account gap to increase to US$ 48 billion or 2.5% of GDP.

# BRAZILIAN ECONOMY OUTLOOK FOR 2009 - 2010

| | 2007 | 2008 | 2009 *estimate* | 2010 *projection* |
|---|---|---|---|---|
| **Economic activity** | | | | |
| **GDP** (annual variation) | 6.1% | 5.1% | **0.0%** | **5.5%** |
| **Industrial GDP** (annual variation) | 5.2% | 4.4% | **-4.5%** | **7.0%** |
| **Household consumption** (annual variation) | 6.1% | 7.0% | **3.7%** | **5.6%** |
| **Gross fixed capital formation** (annual variation) | 13.9% | 13.4% | **-10.8%** | **14.0%** |
| **Unemployment rate** (annual average - % of the labor force) | 9.3% | 7.9% | **8.1%** | **7.6%** |
| **Inflation** | | | | |
| **Inflation** (IPCA - annual variation) | 4.5% | 5.9% | **4.3%** | **4.7%** |
| **Interest rates** | | | | |
| **Nominal interest rates** | | | | |
| (average rate in the year) | 12.03% | 12.45% | **10.13%** | **8.75%** |
| (end of year) | 11.25% | 13.75% | **8.75%** | **8.75%** |
| **Real interest rate** (average annual rate and defl: IPCA) | 7.2% | 6.2% | **5.0%** | **4.3%** |
| **Public accounts*** | | | | |
| **Nominal public deficit** (% of GDP) | 2.80% | 2.00% | **3.75%** | **1.90%** |
| **Public primary surplus** (% of GDP) | 3.45% | 3.70% | **1.55%** | **2.60%** |
| **Net public debt** (% of GDP) | 43.9% | 38.8% | **43.4%** | **40.5%** |
| **Exchange rate** | | | | |
| **Nominal exchange rate - R$/US$** | | | | |
| (average in December) | 1.78 | 2.39 | **1.73** | **1.70** |
| (average in the year) | 1.95 | 1.83 | **1.99** | **1.72** |
| **Foreign trade sector** | | | | |
| **Exports** (US$ billion) | 160.6 | 197.9 | **151.9** | **188.0** |
| **Imports** (US$ billion) | 120.6 | 173.2 | **126.7** | **175.0** |
| **Trade balance** (US$ billion) | 40.0 | 24.7 | **25.2** | **13.0** |
| **Current account balance** (US$ billion) | 1.7 | -28.2 | **-22.9** | **-48.0** |

* Does not includes enterprises of the Petrobras Group

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